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## The Free Lunch Bunch

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**D**id they believe they would be welcomed as liberators? Administration plans to privatize Social Security have clearly run into unexpected opposition. Even Republicans are balking; Representative Bill Thomas says that the initial Bush plan will soon be a "dead horse."

That may be overstating it, but for privatizers the worst is yet to come. If people are rightly skeptical about claims that Social Security faces an imminent crisis, just wait until they start looking closely at the supposed solution.

President Bush is like a financial adviser who tells you that at the rate you're going, you won't be able to afford retirement - but that you shouldn't do anything mundane like trying to save more. Instead, you should take out a huge loan, put the money in a mutual fund run by his friends (with management fees to be determined later) and place your faith in capital gains.

That, once you cut through all the fine phrases about an "ownership society," is how the Bush privatization plan works. Payroll taxes would be diverted into private accounts, forcing the government to borrow to replace the lost revenue. The government would make up for this borrowing by reducing future benefits; yet workers would supposedly end up better off, in spite of reduced benefits, through the returns on their accounts.

The whole scheme ignores the most basic principle of economics: there is no free lunch.

There are several ways to explain why this particular lunch isn't free, but the clearest comes from Michael Kinsley, editorial and opinion editor of The Los Angeles Times. He points out that the math of Bush-style privatization works only if you assume both that stocks are a much better investment than government bonds and that somebody out there in the private sector will nonetheless sell those private accounts lots of stocks while buying lots of government bonds.

So privatizers are in effect asserting that politicians are smart - they know that stocks are a much better investment than bonds - while private investors are stupid, and will swap their valuable stocks for much less valuable government bonds. Isn't such an assertion very peculiar coming from people who claim to trust markets?

When I ask privatizers that question, I get two responses.

One is that the diversion of revenue into private accounts doesn't have to lead to government borrowing, that the money can come from, um, someplace else. Of course, many schemes look good if you assume that they will be subsidized with large sums shipped in from an undisclosed location.

Alternatively, they point out that stocks on average were a very good investment over the last several decades. But remember the disclaimer that mutual funds are obliged to include in their ads: "past performance is no guarantee of future results."

Fifty years ago most people, remembering 1929, were afraid of the stock market. As a result, those who did buy stocks got to buy them cheap: on average, the value of a company's stock was only about 13 times that company's profits. Because stocks were cheap, they yielded high returns in dividends and capital gains.

But high returns always get competed away, once people know about them: stocks are no longer cheap. Today, the value of a typical company's stock is more than 20 times its profits. The more you pay for an asset, the lower the rate of return you can expect to earn. That's why even Jeremy Siegel, whose "Stocks for the Long Run" is often cited by those who favor stocks over bonds, has conceded that "returns on stocks over bonds won't be as large as in the past."

But a very high return on stocks over bonds is essential in privatization schemes; otherwise private accounts created with borrowed money won't earn enough to compensate for their risks. And if we take into account realistic estimates of the fees that mutual funds will charge - remember, in Britain those fees reduce workers' nest eggs by 20 to 30 percent - privatization turns into a lose-lose proposition.

Sometimes I do find myself puzzled: why don't privatizers understand that their schemes rest on the peculiar belief that there is a giant free lunch there for the taking? But then I remember what Upton Sinclair wrote: "It is difficult to get a man to understand something when his salary depends on his not understanding it."

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